

Service Date: March 7, 1984

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER of The Application of The) DOCKET No. 83.3.15
Butte Water Company to Increase Water)
Rates and Modify Rules and Regulations) ORDER NO. 4977b
for its Butte, Montana, Customers.)

APPEARANCES

FOR THE APPLICANT:

Dennis R. Lopach, Attorney at Law, Hjort, Lopach and Tippy,
P.O. Box 514, Helena, Montana 59624.

FOR THE INTERVENOR:

John Allen, Staff Attorney, Montana Consumer Counsel, 34 West
Sixth Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Opal Winebrenner, Staff Attorney, 2701 Prospect Avenue,
Helena, Montana 59620.

BEFORE:

Thomas J. Schneider, Chairman
John Driscoll, Commissioner
Howard L. Ellis, Commissioner

BACKGROUND

1. On March 14, 1983, Butte Water Company (Applicant or BWC) filed an application with the Montana Public Service Commission (Commission) for authority to increase rates and charges for water service to its customers in Butte, Montana. Applicant requested an average increase of approximately 6.03 percent, which constitutes a revenue increase of approximately \$177,606 in annual revenues.

2. Concurrent with its filing for a permanent increase in rates, BWC filed an application for an interim increase in rates of 6.03 percent, equaling a revenue increase of

approximately \$177,606 or 100 percent of the proposed permanent increase.

3. On May 3, 1983, the Commission, having considered the data filed with the Applicant's interim application, issued Order No. 4977 granting the Applicant interim rate relief in the amount of \$39,181 annually.

4. On May 10, 1983, Butte Water Company filed a "Motion to Modify Interim Rate Order No. 4977." The motion requested that Order No. 4977 be modified to allow the Applicant to generate the authorized revenue increase "by increasing the rate for all services provided by the Applicant, other than sprinkling, on the basis of a uniform percentage increase " In the motion, the Applicant stated that it had already mailed its bills for sprinkling service to customers for the 1983 sprinkling season, and, therefore, if the authorized interim revenue increase were spread on a uniform percentage basis to all services, as provided in Order No. 4977, BWC could not collect the full amount of the authorized increase.

5. On May 24, 1983, the Commission, having considered the Applicant's argument that it could not collect the full amount of the authorized revenue increase under the terms and conditions provided in Order No. 4977, issued Order No. 4977a. Order No. 4977a amended Ordering Paragraph No. 2 of Order No. 4 q7, Docket No. 83.3.15, to read:

"The Butte Water Company is to file revised tariff schedules spreading the increased revenues as a uniform percentage increase to all services except sprinkling."

6. On October 19, 1983, pursuant to provisions contained in Commission Rule 38.2.1207, ARM, the Applicant filed revised

exhibits and supplemental testimony which reflected certain very substantial changes in the filed revenues and expenses that occurred in 1983, and which could not be fully quantified at the time of the original filing. The impact of these revisions was to increase the revenue increase request for its Butte service area from \$177,606 to \$204,572.

7. At the public hearing, the Applicant indicated its parent company, Anaconda Minerals, had recalculated pension expense attributable to the Butte, Montana, operations. The Applicant stated this recalculation resulted in an annual expense increase of \$18,497, and that this expense increase had not been included in its revised exhibits submitted on October 19, 1983.

BWC requested that the Commission, during its deliberations on the merits of the Applicant's proposed rate adjustment, consider this additional expense increase as a possible offset against previously identified expense adjustments that may be disallowed by the Commission. The Applicant did not request an adjustment in the overall revenue increase request as previously filed on October 19, 1983.

Absent objections from any party participating in this proceeding, and being cognizant of the fact that the increased pension expense did not impact the overall revenue increase requested in this docket, the Commission agreed to consider the increased pension expense as a possible offset for any previously identified expense increases that may be disallowed.

8. At the public hearing, all parties agreed to a waiver of the 9-month deadline provided for in Section 69-3-302(1), MCA, and established a 60-day extension on this deadline as being a reasonable period within which the Commission should

render its final decision.

9. At the public hearing, the Applicant presented the following witnesses:

Gary Mannix, President and General Manager of BWC

Elmer Moke, Rate Consultant

C.M. "Skip" Dunfee, Controller BWC

10. The Montana Consumer Counsel presented the testimony of two public witnesses at the hearing.

11. The year ending December 31, 1982, test year was uncontested and is found by the Commission to be a reasonable period within which to measure the Applicant's utility revenues, expenses, and returns for the purpose of determining a fair and reasonable level of rates for water service.

ANALYSIS AND FINDINGS OF FACT

CAPITAL STRUCTURE

12. The Applicant proposed the following capital structure for rate case presentation:

Description	Amount	Ratio
Debt	\$3,888,889	124.2%
Equity	(757,768)	(24.2%)
TOTAL	\$3,131,121	100.0%

The capital structure proposed by the Applicant was not challenged by any party participating in this proceeding, and, therefore, is accepted by the Commission.

COST OF DEBT

13. The debt capital of the Applicant consists of a loan from the Atlantic Richfield Company (ARCO), its parent company, having a term of 10 years and carrying an interest rate of

14.04 percent. This loan arrangement was executed between the parties (BWC & ARCO) in compliance with this Commission's Order No. 4801a, wherein the Commission found that the loan arrangements then in existence were imprudent. The Commission finds the cost of this debt to be reasonable and is accepted by the Commission.

14. The Commission stated the following in its Order No. 4896a:

"The Commission, in discussing the Applicant's cost of debt in Order No. 4801a, indicated that if the Applicant was successful in obtaining alternative financing of its debt at an interest rate lower than that accepted in Order No. 4801a, that the Commission would allow the Applicant a continued cost of debt of 15.18 percent as approved in Order No. 4801a. The Commission conditioned this allowance on the proviso that the Applicant utilize any funds generated, in excess of its actual cost of debt, to finance the costs of an accelerated reconstruction program to bring the water system up to modern standards.'"

In the Commission's Order No. 4896a, the Commission allowed the Applicant a debt cost of 15.18 percent and in Finding of Fact No. 11 of Order No. 4896a, stated the following:

"The Commission finds it appropriate to allow the Applicant a cost of debt of 15.18 percent and that the Applicant should utilize any funds generated in excess of its actual debt costs to make necessary capital improvements to the system and carry the costs of said improvements on its books as customer contributed capital. "

The preceding two excerpts from this Commission's Order No. 4896a indicate that the Commission was under the impression that the water facilities of BWC were in need of extensive renovation and replacement. In an effort to accelerate reconstruction of the facilities, with minimal impact on the ratepayer, the Commission was willing to authorize, and did authorize, a cost of capital in excess of actual cost to accomplish that reconstruction. 15. During the course of direct examination, Mr. Gary Mannix, President of BWC, stated:

"...I personally haven't identified any areas that need major reconstruction...But at this time I see no reason for a major reconstruction of the system.'" (Tr. page 158)
Based upon the testimony of Mr. Mannix, the Commission

concludes that it has been under the mistaken impression that the BWC water facilities are in need of major reconstruction. Given the fact that no need exists for major reconstruction of water facilities, the Commission finds that the Applicant's cost of debt should not exceed that set by its contractual obligation.

16. The Commission, based upon the testimony in this docket, finds that the Applicant should be allowed a debt cost of 14.04 percent, which is the interest rate applicable to the loan agreement entered into between BWC and ARCO.

The Commission will reiterate its statement from Order No. 4896a that it is the Commission's opinion that good business practice dictates that BWC examine the possibility of obtaining lower cost debt capital.

CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

Description	Amount	Ratio	Cost	Weighted Cost
Debt	\$3,888,889	124.2%	14.04%	17.44%
Equity	(757,768)	(24.2%)	14.04%	(3.40%)
Composite Cost of Total Capital				14.04%

RATE BASE

17. The Applicant proposed an average original cost-depreciated rate base of \$3,722,676.

18. During the course of cross-examination, the Montana Consumer Counsel questioned the accuracy of the Applicant's proposed average original cost-depreciated rate base as it related to the Applicant's treatment of "Contributions in Aid of Construction" (CIAC) and "Credit for Accrued Property Taxes." The Consumer Counsel contended that the Applicant's treatment of these items resulted in an overstatement of rate base on which the Applicant should be allowed a return.

19. Both the Montana Consumer Counsel and the Applicant

submitted briefs concerning the issue of appropriate treatment of CIAC in determining rate base.

The Montana Consumer Counsel's brief provided numerous case cites supporting its position that it was inappropriate to allow the Applicant to add back accumulated depreciation on CIAC in the amount of \$250,957 when determining rate base on which the Applicant should be allowed a return. The Applicant, who utilized the add back of accumulated depreciation on CIAC procedure, conceded in its reply brief that the position presented by the Consumer Counsel represented the majority case law view for treatment of CIAC in determining rate base.

The Commission, having considered the arguments presented by the Applicant and the Consumer Counsel, finds that the Applicant should not be allowed to add back the accumulated depreciation on CIAC in the amount of \$250,957 for purposes of determining rate base, because it results in the ratepayer paying a return on funds that have been provided by the ratepayer.

20. The Consumer Counsel also took the position that the Applicant should not be allowed to expense depreciation on CIAC.

The Commission is cognizant of the fact that the plant provided by CIAC is a plant that has been provided by the ratepayer, and, therefore, should not be included in rate base and allowed to earn a return to the investor. The question of allowing depreciation expense on CIAC is a philosophical one and requires examination.

In general terms depreciation is for the purpose of

recovering original investment in property over the useful life of that property, and is generally recognized as a lost usefulness of the asset or asset group. An allowance for depreciation on CIAC is based on the assumption that the plant provided by CIAC will have to be replaced at the end of its useful life, and, by allowing depreciation expense on CIAC, the utility will have funds available to replace this plant without need of further CIAC.

The allowance for depreciation on CIAC is, therefore, not considered depreciation, but rather is an allowance for replacement of the plant provided through CIAC. This method of accumulating funds for replacement of the plant provided through CIAC prevents the utility from increasing its rate base, except to the extent the replacement cost of the contributed plant exceeds the amount of the original CIAC.

This method of funding for replacement of the plant provided through CIAC was not fully explored on the record in this docket; therefore, the Commission reserves ruling on the propriety of this funding mechanism. The Commission finds the Applicant should be allowed to continue its practice of expensing depreciation on CIAC, until such time as the Commission has adequate information on the record to make a final ruling. The rationale behind allowing continuance of the depreciation in this docket centers around a lack of information, relative to who provided the original CIAC and whether the philosophy of allowing a depreciation expense is an overall benefit or detriment to the ratepayer.

21. In prior proceedings before this Commission, the Applicant has used simple accumulation of monthly tax accruals for purposes of determining working capital available from property tax accruals. In this docket, the

Applicant revised its procedure and proposed that working capital available from property tax accruals be determined based on monthly use of funds coming from the cumulative monthly tax accruals as limited by cumulative monthly funds available. In other words, the Applicant is proposing that the Commission accept the analysis made on page 2 of 38.5.141, Applicant's Exhibit No. 2, as a lead-lag study. The Commission rejects the Applicant's proposed modification because the analysis limits the examination of the timing of receipts and payments to only two accounts, which is insufficient to produce any meaningful data. The Commission finds, for purposes of determining cash working capital available from property tax accruals, it is appropriate to continue the procedure that has been used and accepted in prior proceedings before this Commission.

22. Consistent with the Applicant's proposed modification outlined above, the Applicant proposed that the "Credit for Accrued Property Taxes" should be in the amount of \$80,416. Using the procedure consistently accepted by the Commission in the past, the "Credit for Accrued Property Taxes" increases to \$116,334. Therefore, the Commission finds that the Applicant's proposed original cost-depreciated rate base should be decreased by \$35,918.

23. Based upon the preceding Findings of Fact, the Commission finds the Applicant's original cost-depreciated rate base should be \$3,435,801.

OPERATING EXPENSES

24. The Applicant, in its Exhibit No. 4, proposed total test period operating revenue deductions of \$2,315,632.

25. The Commission has determined the following adjustments to test period operating revenue deductions are appropriate:

a. Depreciation expense should be reduced by \$5,685 to reflect appropriate expense level associated with plant retirements.

b. Fringe benefit expense for salaried employees should be reduced by \$7,341 to reflect savings in this account as a result of employee retirements. This expense savings was calculated by using the ratio determined by the Applicant on page 157.3a of Exhibit No. 4 and applying it to expense savings resulting from the employee retirements ($\$24,308 \times .302 = \$7,341$).

c. Pension expense should be increased by \$18,497 to reflect the actual pension costs being charged BWC as calculated by its parent company, Anaconda Minerals.

26. The Montana Consumer Counsel, during its cross-examination of Company witnesses, proposed that salary expense associated with employee retirements should be amortized over a period of years, instead of being charged as a current cost during the test period as proposed by the Applicant. The Consumer Counsel properly states in its initial brief that this item of expense is nonrecurring in nature, and that traditional ratemaking treatment of this expense would dictate that it be amortized.

The Commission on many occasions has required utilities under its jurisdiction to amortize items of expense which are nonrecurring in nature. In this instance, given the financial condition of BWC, its mounting operating losses, its attempts to economize through renegotiation of its collective bargaining agreements and implementation of an early retirement program to decrease future operating expenses, the Commission finds it appropriate to charge salary expense

associated with employee retirements as a current cost in an effort to maintain the financial integrity of BWC. To reflect the expense savings that will accrue to BWC in future periods, the Commission should require BWC to file revised tariffs that will become effective January 1, 1985, which reflect a reduction in its overall revenue requirement amounting to \$101,622, which equals the expense savings, including fringes, associated with salaried employee retirements ($\$78,051 \times 1.302 = \$101,622,.$

27. Based upon the preceding Findings of Fact, the Commission finds the Applicant's total operating revenue deductions, prior to January 1, 1985, to be \$2,321,103, and subsequent to January 1, 1985, to be \$2,219,481. OPERATING REVENUE

28. The test period operating revenues are not a contested issue in this case. The Applicant utilized the 12 months ended December 31, 1982, to determine the test year revenues under the rates which became effective November 15, 1982, and adjusted for loss of sales to the Anaconda Minerals Company. Total test year revenues of \$2,676,173, as calculated by the Applicant, are accepted by the Commission.

Operating Income for BWC is found to be \$355,070:

Operating Revenue	\$2,676,173
Operating Deductions	2,321,103
Operating Income	\$ 355,070
REVENUE REQUIREMENT	
Rate Base	\$3,435,070
Rate of Return	14.04%
Return Requirement	\$ 482,386
Adjusted Balance Available for Return	355,070
Return Deficiency	127,316
Revenue Deficiency	127,431
MCC Tax at .09%	115

29. In order to produce a return of 14.04 percent on the Applicant's average original cost-depreciated rate base, the Applicant will require additional annual revenues in the amount of \$127,431 from its Butte, Montana, water utility.

SERVICE

30. The discussion on the record in this docket was limited regarding the sand problem experienced by consumers of the water utility.

There was public testimony indicating that the problem still exists at a diminished level, and Company records, as testified to by Mr. Mannix, indicate that service calls are down to the level experienced in 1978, which predates the introduction of sand into the water utility facility. Based upon this testimony, the Commission is of the opinion that continuation of a rate differential, as ordered in Order No. 4801a, is appropriate, but at a reduced level so as to reflect the increased quality of service received by consumers experiencing the sand problem.

The Commission finds that a rate differential between sand trap customers and those without sand traps should be continued. The rate for customers with sand traps should be adjusted, however, to reflect a rate which is only \$1. 25 below the rate approved for consumers not having a sand trap.

RATE DESIGN

31. The rate design proposed by the Applicant was not challenged by any party participating in this proceeding. The rate design appears to equitably spread the increase among the various customer categories! therefore, the Commission

accepts the Applicant's proposed rate design.

MISCELLANEOUS

32. In Order No. 4896a, the Commission discussed the Applicant's practice of providing free water service to certain consumers connected to its facilities and ordered that the Applicant discontinue this practice. Order No. 4896a provided that the Applicant would start assessing those consumers that had been receiving free water service one-third of the appropriate charge and that subsequent rate orders would be used to phase in the remaining two-thirds of the full charge.

The Commission finds that the Applicant should start assessing consumers that had been receiving free water service two-thirds of the respective consumer's appropriate charge.

33. In response to a data request of the Commission staff, the Applicant indicated that there was water utility plant that had been dedicated solely to the provision of service to the Anaconda Minerals Company. The Anaconda Minerals Company has discontinued water service at the majority of its service connections with BWC. In an effort to reduce the revenue responsibility of the remaining ratepayers, the Commission finds that the Applicant should bill Anaconda Minerals for any and all maintenance expenses incurred which relate to the plant that was dedicated solely to the provision of water service to Anaconda Minerals.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this

proceeding. Section 69-3-102, MCA.

2. The Commission afforded all parties interested in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.

3. The rates approved herein are reasonable, just, and proper. Section 69-3-201, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. Butte Water Company shall file rate schedules which reflect an increase in annual revenues of \$127,431 for its Butte, Montana, water service. The increased revenues shall be generated by increasing rates and charges to all customer classifications and assessment of two-thirds of the appropriate charge for consumers previously receiving free water service. However, the annual revenue increase shall be reduced in accordance with the limitation in Finding of Fact No. 30.

2. Butte Water Company shall file revised rate schedules on or before January 1, 1985 reflecting a reduced revenue requirement as provided in Finding of Fact No. 26.

3. The rates approved herein shall not become effective until approved by this Commission.

4. The revenues approved herein are in lieu of, and not in addition to, those approved in Order No. 4977.

5. A full, true, and correct copy of this Order shall be sent by first class mail to the Applicant and to all parties of

record.

6. DONE IN OPEN SESSION at Helena, Montana, this 27th day of February, 1984 by a 3 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Thomas J. Schneider, Chairman

John B. Driscoll, Commissioner

Howard L. Ellis, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.